

Exhibit No. 35Date 3-21-11Bill No. HB 2

House Appropriations Committee

Montana Department of Revenue

Budget Exhibits

March 4, 2011

and

Senate Finance & Claims

Budget Exhibits

March 21, 2011

Montana Department of Revenue Average Return on Investment in Tax Administration FY2010

Step 1: Total Revenue Generated per Dollar Expended

48:1
<u>\$2,615,415,319</u>
\$54,620,914

Step 2: Dividing Revenue Generated per Dollar Expended among Three Major Functions

Liquor

9:1
<u>\$37,519,372</u>
\$4,007,349

State Level Taxes
(less 101 mills)

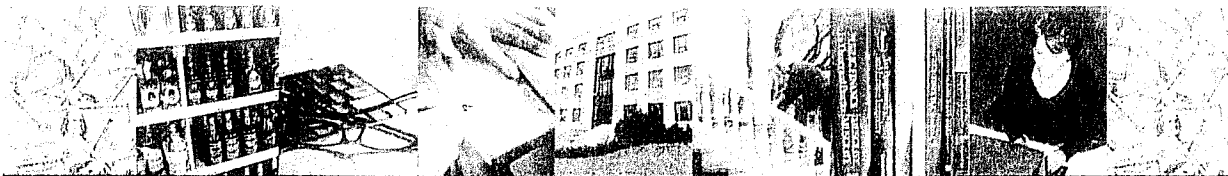
72:1
<u>\$1,329,367,764</u>
\$18,568,662

Property

(includes 101 mills)

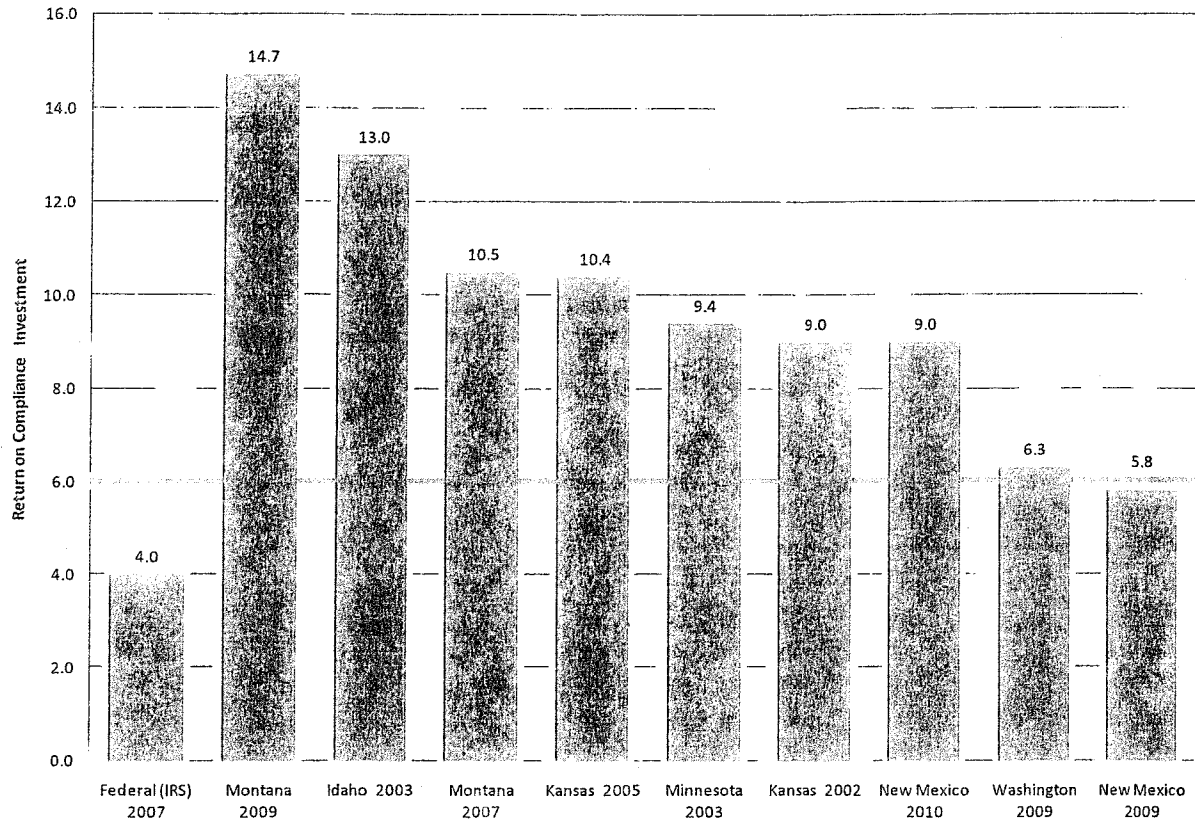
39:1
<u>\$1,248,528,183</u>
\$32,044,903

Note: Expenditures from support divisions (DO, IT/PRO, CSRM) prorated to major functions

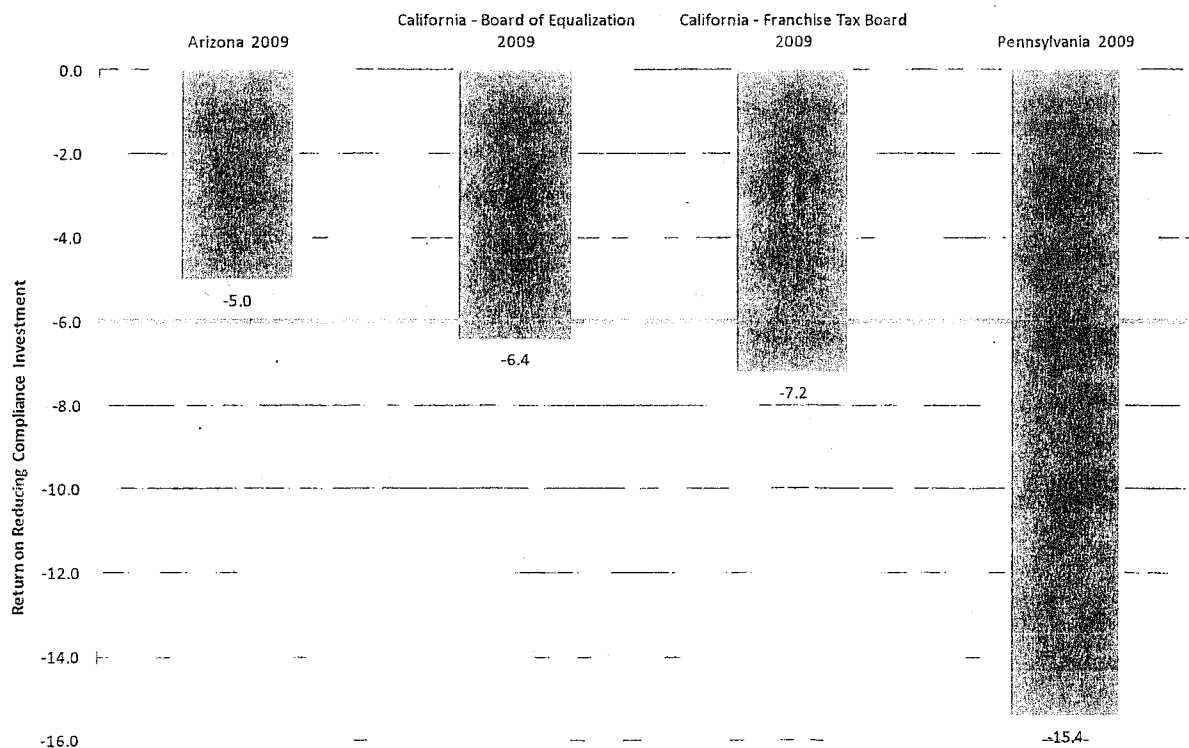


Montana Department of Revenue

Impact of Investing in Tax Compliance



Reduction in Compliance Investment



Choices for Revenue Agencies, Including the Montana Department of Revenue, Have Consequences

As a standardized practice, other states and the federal government collect information and develop estimates of the additional (or reduction) in tax revenue received for each additional (or reduced) dollar in the compliance department's budget. The examples provided in the table below exemplify the benefits of investing in compliance and the consequences of cutting collecting agencies' budgets.

Revenue Generated (or Lost) From Additions (or Reductions) in Compliance Initiatives					
<u>Government</u>	<u>Year</u>	<u>Investment or (Reduction)</u>	<u>Revenue or (Loss)</u>	<u>Return on Investment</u>	<u>Source</u>
Federal (IRS)*	2007	\$11,100,000,000	\$44,400,000,000	4 to 1	1
Arizona	2009	(\$10,800,000)	(\$54,000,000)	5 to 1	5, 6
California - Board of Equalization	2009	(\$41,500,000)	(\$264,000,000)	6.4 to 1	2
California - Franchise Tax Board	2009	(\$65,000,000)	(\$465,000,000)	7.2 to 1	2
Idaho	2003	\$926,000	\$12,000,000	13 to 1	3
Kansas	2002	\$6,000,000	\$54,000,000	9 to 1	3
Kansas	2005	\$1,440,000	\$15,000,000	10.4 to 1	3
Minnesota	2003	\$10,300,000	\$97,200,000	9.4 to 1	3
Montana	2007	\$1,052,893	\$11,085,122	10.5 to 1	4
Montana	2009	\$1,257,907	\$18,500,242	14.7 to 1	4
New Mexico * (first year)	2009	\$5,000,000	\$29,000,000	5.8 to 1	3
New Mexico * (ongoing)	2010	\$5,000,000	\$45,000,000	9 to 1	3
Pennsylvania*	2009	(\$13,000,000)	(\$200,000,000)	15.4 to 1	7
Washington *	2009	\$10,700,000	\$67,800,000	6.3 to 1	3

* Projected

Sources:

1. Reducing the Federal Tax Gap - A Report on Improving Voluntary Compliance - Internal Revenue Service, U.S. Department of the Treasury - 8/2/2007.
2. Furloughs at the Franchise Tax Board: Loss is Seven Times Greater than the Savings - California Senate Office of Oversight and Outcomes - 2/12/2010.
3. Idaho's Tax Gap, 2009 Estimating Idaho's tax Gap and Developing Strategies to Reduce It - Idaho Tax Commission - 11/2009.
4. Montana Department of Revenue 2007 Biennium Compliance Package Collections by Month and 2009 Biennial Compliance Package Collections by Month.
5. Stronger Arizona - An estimate of state general fund losses as a result of Arizona Department of Revenue budget cuts.
6. Arizona Department of Revenue - Office of the Auditor General, "division analysis indicates corporate income tax audits result in \$15 in assessments for each \$1 spent, while audits of individual income taxes result in \$5 in assessments for each \$1 spent."
7. The Pennsylvania Budget and Policy Center: 30 Ways in 30 Days: Revenue Collections - Proposed Cuts to Revenue Department Penny Wise and Pound Foolish.

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Tax auditors bring in more than twice revenue goal

Posted Friday, February 4, 2011 12:15 am

The Associated Press |

BOISE — The Idaho State Tax Commission's tax compliance initiative is well ahead of projected goals, with temporary auditors bringing in \$32 million in their first 18 months on the job.

The agency is looking to expand the program by making 48 temporary auditors permanent — and adding more in coming quarters to pursue tax scofflaws.

Tax Commissioner David Langhorst said Thursday that continued expansion hinges on hitting goals every quarter.

That's a condition Gov. Butch Otter has put on the program.

So far, however, the new auditors are worth their weight in collections.

Last year, auditors brought in \$20.5 million, twice their goal.

Through this year's first six months, they've collected \$12.2 million, already above the full-year, \$11.5 million goal.

The program's four-year projection is \$67 million in increased revenue.

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More about **State Revenue**

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- **ARTICLE:** State budget takes big hit
- **ARTICLE:** Otter: Revenue supports roads
- **ARTICLE:** Layoffs at Micron could cut revenue
- **ARTICLE:** Two state agencies require furloughs

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Business and Income Taxes Division

The following provides a discussion for the need to continue to fully fund the Division compliance staff and the need for the additional staff requested in the Governor's budget. In the Governor's budget the request for an additional funding of \$1,000,000 is forecasted to return \$5,000,000 in general fund revenue.

The following discussion highlights several areas of non-compliance that current staff focuses on and the potential issues/work the requested staff would be involved with.

Cross-Matches

The Division uses cross-matching techniques to identify non-filer and non-compliance cases. Cross-matching is a process of matching the Department's information to information received from non-Department data sources. Some of the outside agencies that the Department has information sharing agreements with include: Internal Revenue Service; Department of Justice; Department of Labor and Industry; Fish, Wildlife and Parks; Department of Public Health and Human Services; and the Supreme Court.

Non-Filer Cases: Over the last several years, the Division has identified approximately 31,900 non-filer cases. The Division has been able to work 16,300 of these cases. 15,600 of these non-filer cases have yet to be worked and may never be worked with the current staffing levels.

Non-Compliance Cases: Over the same period, the Division has identified 140,000 specific cases of non-compliance through our cross-matching techniques. Of these cases, the Division has been able to work 42,000 cases. These 42,000 cases generated almost \$13,000,000 in compliance collections. Unfortunately, there are 98,000 cases that remain to be worked.

Pass-Through Entity Compliance

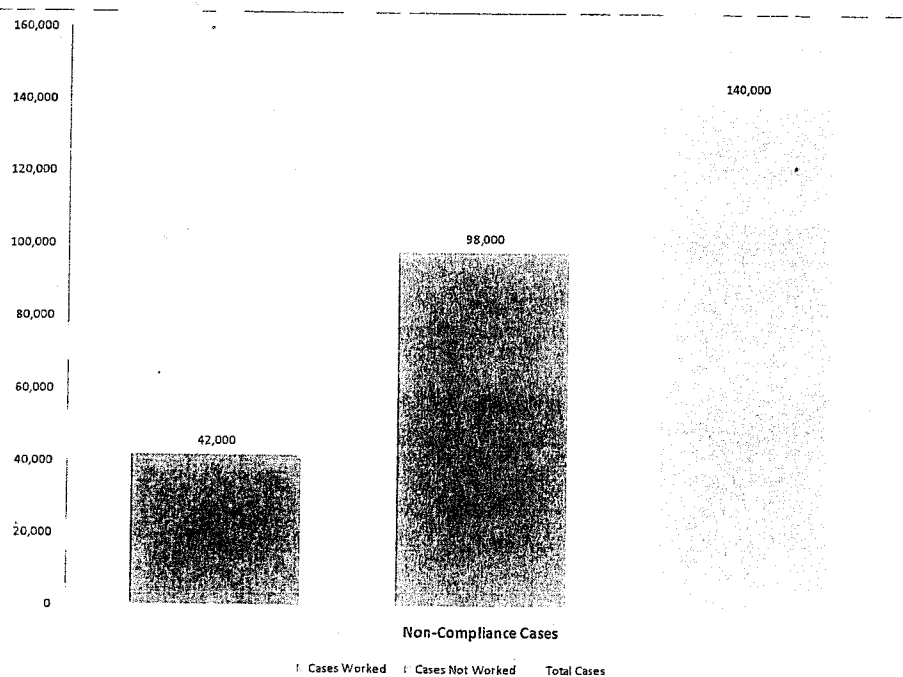
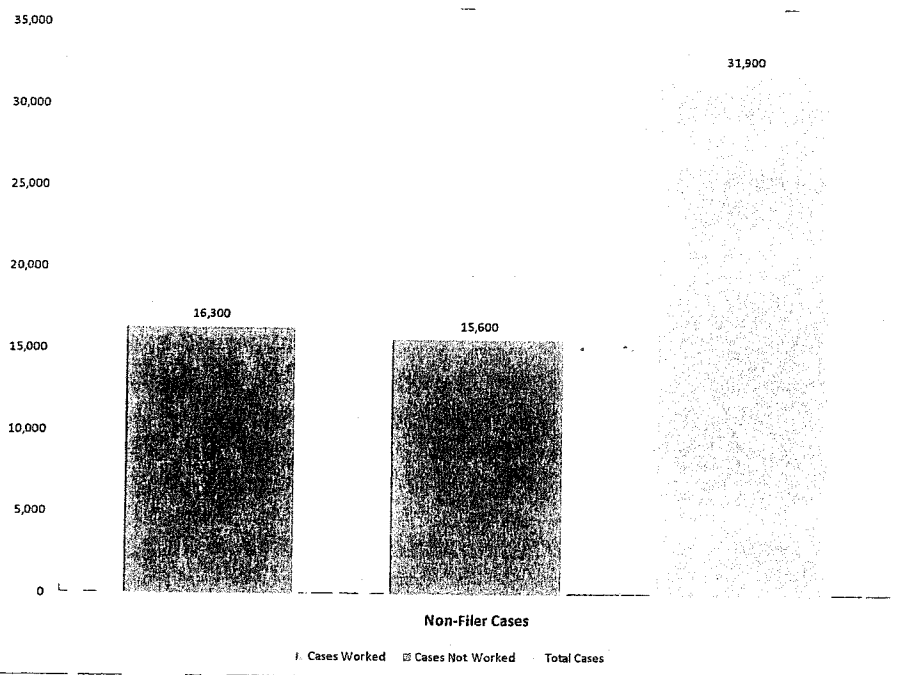
With the continued explosive growth of pass-through entities (partnerships and s-corporations) and the complexity of the pass-through entities multi-tiered structure, the Division is having difficulty providing the necessary compliance coverage.

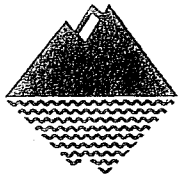
Compliance Cases: The Division has only been able to work a very small number of pass-through entity non-compliance cases. But the cases that were worked in fiscal year 2010 totaled \$7.3 million in compliance collections. With a properly staffed pass-through compliance unit and with the additional requested FTE the Division anticipates that similar results would be achieved in the 2013 Biennium.

Income Reporting Audits

Because Montana's income tax system is based on the federal system, it is imperative that the Division make sure that the federal information reported on Montana's tax returns is correct.

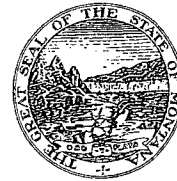
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Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

Property Assessment Division Staffing Levels – past to present

North Central Montana – Cascade, Pondera, Toole, Teton, Glacier

Year	Staffing Levels
1996	39
2010	27
Decrease in Staff over time	12

North Central Montana has experienced a 31% decrease in staffing level since 1996.

Eastern Montana – see county detail attached

Year	Staffing Levels
1994	108.5
2010	76
Decrease in Staff over time	32.5

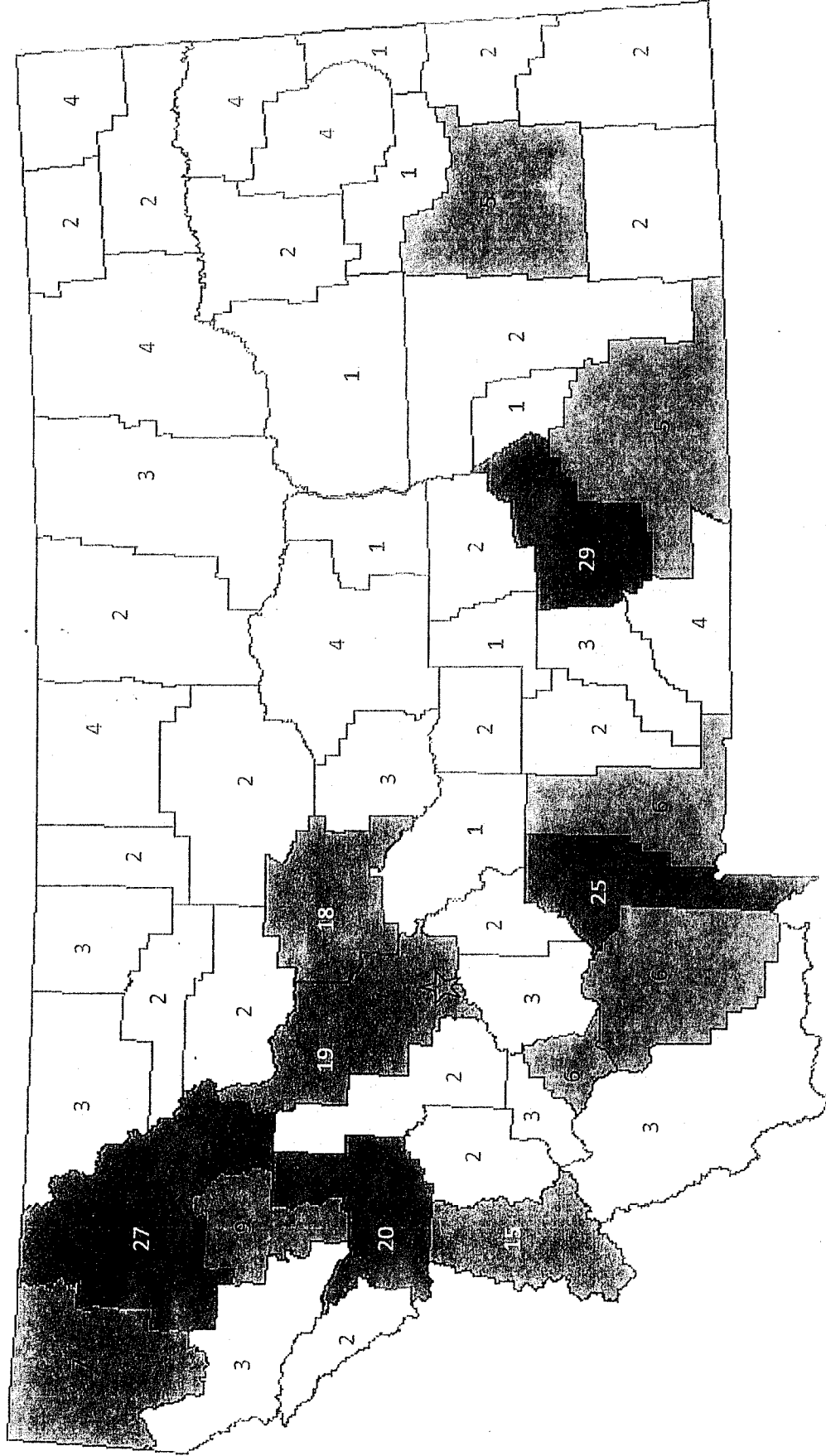
Eastern Montana has experienced a 30% decrease in staffing level since 1994.

Eastern Montana county detail

County	1994 staff	Current Staff	Staff reduction
Big Horn	6	3	3
Carbon	5	4	1
Carter	2	1	1
Custer	8	5	3
Daniels	2.5	2	0.5
Dawson	4	4	0
Fallon	4	2	2
Golden Valley	3	1	2
Meagher	2	1	1
Musselshell	5	1	4
Powder River	4	2	2
Prairie	2.5	1	1.5
Richland	5	4	1
Roosevelt	3	2	1
Rosebud	6	2	4
Sheridan	4	3	1
Stillwater	4	2.5	1.5
Sweet Grass	2	1.5	0.5
Treasure	1	1	0
Wheatland	3	2	1
Wibaux	2.5	1	1.5
Yellowstone	30	30	0
Total	108.5	76	32.5

Property Assessment Division (PAD) Staff Locations

As of January 7, 2011



Number of Property Assessment Division FTE

1 2-4 5-9 10-20 21-30

Total PAD Field Staff - 291

Total PAD Central Staff - 17

Total PAD Staff - 308



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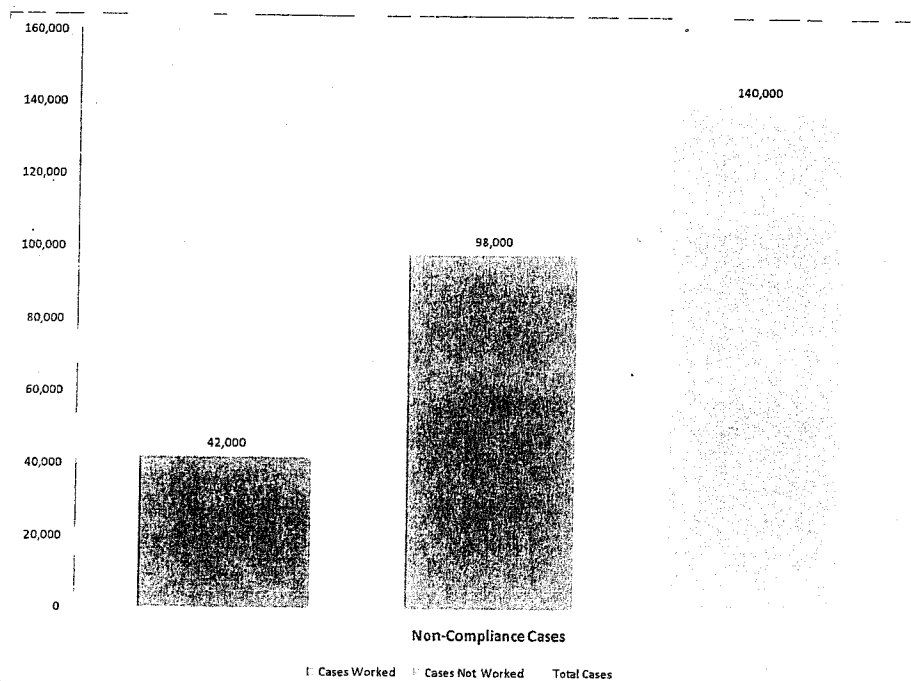
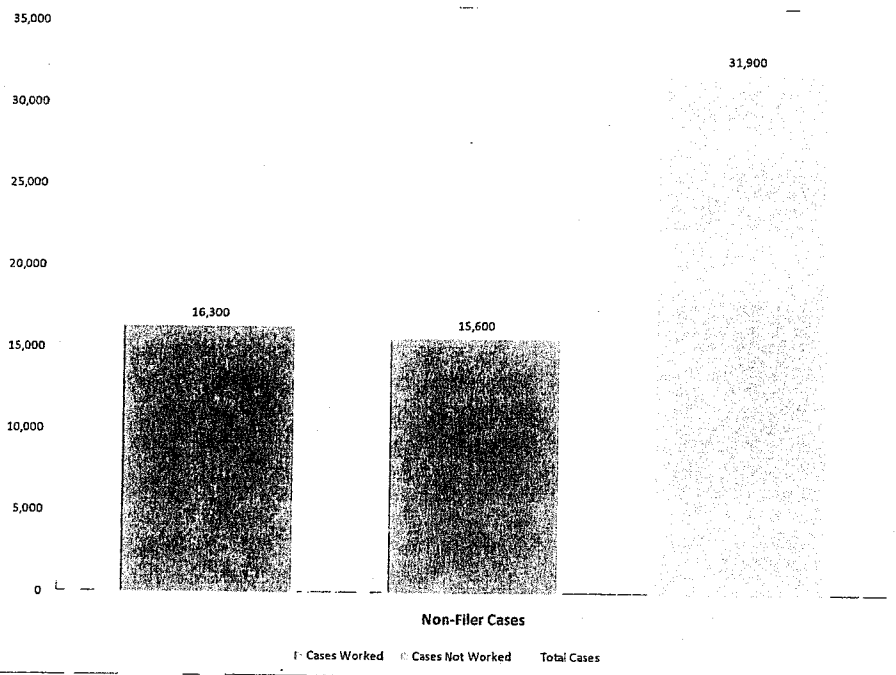
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**Montana's Department of Revenue:
A Record of Effective, Efficient
Tax Administration as a
Unitary Business Operation**

January 3, 2011



Montana Department of Revenue Administers Revenue Laws

The mission statement of the Montana Department of Revenue (DOR) describes what the agency strives to accomplish.

The quality of life for all Montanans is better because we excel at public service and effective administration of the tax and liquor laws. We do this by:

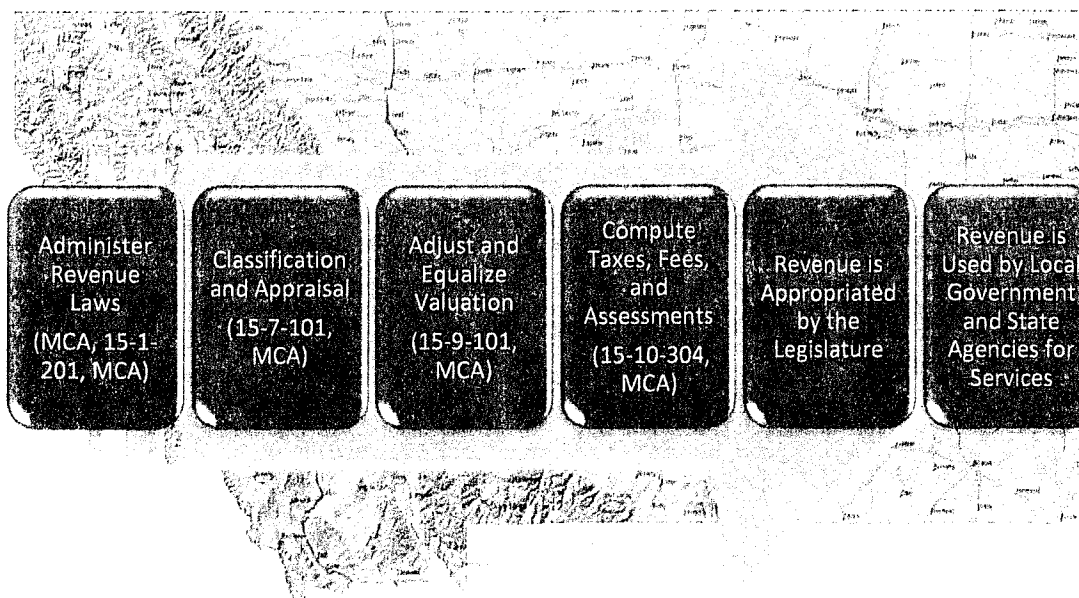
- Ensuring that revenues intended by the legislature to be raised are collected to serve Montanans,
- Advancing equity and integrity in taxation,
- Providing effective and respectful service,
- Protecting the public health and safety, and achieving efficiency in liquor administration, and
- Improving public understanding of Montana's revenue system.

The DOR pursues this mission within the framework of our core values, which are rooted in the Montana Constitution and in fundamental values proven by human experience to lead an organization or community forward in a continuous positive manner.

These core values include:

- Respect for all persons
- Integrity and justice
- Productivity and effectiveness
- Teamwork and community

The duty of the DOR is to administer the revenue laws as defined by statute, set forth in title 15 of the Montana Code, with the exception of gasoline tax. The DOR is also responsible for administering the alcohol and tobacco laws set forth in Title 16 of the Montana Code.



Montana is one of two states that require their state revenue department to appraise all property within the state. This is in contrast to other states, where it is the individual cities and counties appraising property within their boundaries. The Montana Constitution requires the state to classify, appraise, and keep record of all property within the state. Montana law assigns this constitutional responsibility to the DOR. This approach promotes equity in valuation throughout the state.

Additionally, Montana statute (15-9-101, MCA) requires the DOR to adjust and equalize the valuation of taxable property in and among the separate counties and between taxpayers to secure a fair, just, and equitable valuation of all taxable property among counties, between classes of property, and between individual taxpayers.

After receiving the number of mills to be levied for each taxing jurisdiction, Montana statute (15-10-305, MCA) directs the DOR to compute and itemize the taxes, fees, and assessments to be levied on each property's tax bill.

These additional responsibilities place Montana's DOR in a unique position – in terms of share of responsibility for state and local tax systems – compared to other states' revenue departments.

Montana Department of Revenue Collects Revenue

The product of the Montana Department of Revenue (DOR) is collected taxes that are deposited in both state special revenue funds and the state general fund. These taxes are then distributed by the Montana Legislature to schools, local governments and other state agencies. In FY2010 alone, the DOR collected \$1.5 billion on behalf of schools, local governments and the state. Without the DOR, local governments would not be able to collect \$1.0 billion in property tax revenue. In total, the DOR was responsible for the collection of more than \$2.5 billion in taxes for schools, local governments and the state.

In a similar fashion to the cashier at a restaurant or the collections department of a large firm, the DOR's primary focus – as directed by law – is collecting revenue. The revenue is then appropriated by the Montana Legislature to local government and other state agencies where it is used to promote the quality of life for all Montanans by funding programs enhancing public health, education, law enforcement, utilities, fire safety, roads, parks, and other infrastructure.

To complete its duty to the taxpayers of Montana, the DOR must complete many tasks. The list below highlights many of the ways the DOR has worked to meet its duties to the taxpayer:

- Appraised all real and personal property in the state to meet the Constitutional requirement of equalized property valuations
- Improved equity for all taxpayers by requiring, as much as possible, that those not paying their fair share, including non-residents, do so
- Provided county offices so taxpayers have access to the DOR locally
- Created a customer service center so taxpayers can have their questions answered over the phone or request information
- Assisted small businesses with convenient one-stop licensing
- Increased taxpayer convenience with electronic and paper returns and instructions that translate complex laws into manageable filing steps
- Accounted for all taxes collected and reported the information in a transparent manner
- Managed and kept secure individual taxpayer's personal information
- Returned lost money and property to rightful owners
- Processed paper and electronic tax returns in an efficient manner so Montanans received their refunds as soon as possible
- Controlled and distributed alcoholic beverages in a way that ensures public safety

Revenue is used to promote the quality of life for all Montanans

The legislature appropriates revenue to local governments and state agencies

DOR and county governments collect revenue

Taxpayers pay taxes and fees

Parts Form the Whole at Montana Department of Revenue

The Montana Department of Revenue (DOR) is composed of six interrelated parts that work together to produce local and state revenue, the agency's primary product. Each part contributes to the whole output of the DOR.



The **Information Technology and Processing Division** is integral to the day-to-day functioning of the DOR. The division is responsible for processing tax returns and payments for the 40 taxes administered by the DOR. It provides computer and network support, application development, information security, and help desk support for the revenue collecting units.

The **Citizen Services and Resource Management Division** provides consistent answers and service to Montana citizens, businesses and nonresident taxpayers through a call center, one-stop licensing, forms design, unclaimed property management, and other taxpayer services. The division also provides internal support for accounting, purchasing, and facilities and asset management.

The **Business and Income Taxes Division** administers and ensures compliance with Montana tax law for the majority of state taxes and completes appraisals and assessments of industrial and centrally assessed property.

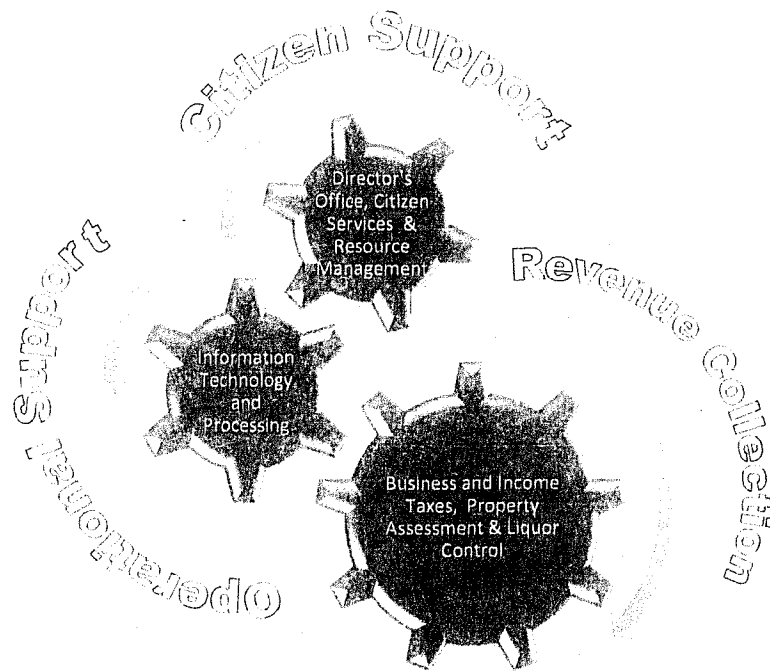
The **Liquor Control Division** administers the state's Alcoholic Beverage Code, which governs the control, sale, and distribution of alcoholic beverages. The division includes liquor distribution and liquor licensing, which generate liquor tax revenue.

The **Property Assessment Division** is responsible for the valuation and assessment of real and personal property throughout the state for property tax purposes, on behalf of state government as well as all local government. The division has a central office located in Helena and four regional areas. A local DOR office is located in each county seat across Montana.

The **Director's Office** supports and guides the agency's operations, and provides critical legal and research functions. It ensures that the DOR values, supports and develops its employees. This division is responsible for the fiscal analysis of legislation and research to support policy-making of the executive and legislative branches. Finally, it makes certain that the laws in Title 15 and 16 of Montana Code Annotated are applied fairly to the citizens and taxpayers of Montana.

Each Division of Montana Department of Revenue Supports Revenue Collection

The divisions of the Montana Department of Revenue (DOR) support revenue collection as a unitary business operation.



Direct Revenue Collection

Three divisions – Business and Income Taxes, Property Assessment and Liquor Control – are responsible for the majority of direct revenue collection in the DOR, but these divisions could not operate individually. All three divisions rely on the interaction of all the other functions of the DOR. The various parts cannot operate without each other.

Operational Support

Not a day's work could be accomplished without the vital services provided by operational support. The DOR cannot function without:

- Computers, the Gentax software system, and the technology support provided by **Information Technology**.
- Offices, pens, lights, computers, workspaces and desks provided by **Resource Management**
- Forms, instructions and other information provided by **Citizen Services**, which help and instruct taxpayers on when, where, or how to file and pay taxes.
- Work done by **Processing**, which ensures that submitted payments are opened, electronically transferred, or otherwise processed.

- Sustained efforts by **Legal Services** to ensure equity under the law and to address noncompliance and support collection activity, which aid the Business and Income Taxes Division, Property Assessment Division and Liquor Control Division to experience a high degree of voluntary compliance and revenue collection.

Every Function is Interdependent

If one of the DOR's interrelated services were to disappear, the result would be failure of the revenue collection process.

Without tax forms, no payments are made.

Without the call center, questions are disregarded, errors increase and taxpayers' voluntary compliance decreases.

Without processing, no payments are received or credited.

Without computers and software, revenue collection and property valuation slows to a halt, and no information is stored, analyzed or kept secure.

Without resource management, revenue is not properly allocated and both local and state offices deteriorate and cease operating efficiently.

Without legal services, consequences for non-compliance are not enforced, active compliance is reduced and property values are shifted unfairly among large businesses, homeowners, small businesses and agriculture.

Without human resources, no workforce is recruited, trained and paid.

Without liquor control, there is no safe distribution of controlled substances.

Without assessment and valuation, taxes would be based on speculation.

Without research, no information is provided to law makers.

Without tax audits, compliance is reduced.

Without direction, the DOR functions without purpose.

As you can see, the DOR functions interdependently. Each function is necessary to meet the DOR's obligation to administer Montana's revenue collection laws.

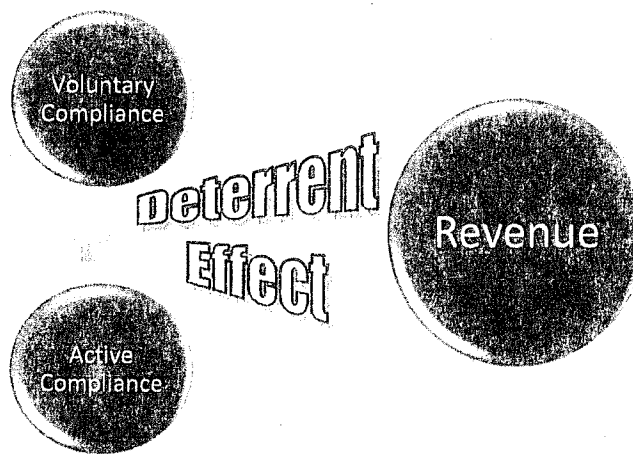
Montana Department of Revenue's Tax Collection: Two Interrelated Types of Revenue

Tax revenue collected by the Montana Department of Revenue (DOR) can be broken into two related forms of compliance: voluntary and active.

Voluntary compliance is met when taxpayers file timely returns, accurately reporting and paying tax obligations. The DOR provides the necessary framework for voluntary compliance by helping citizens understand and comply with the tax law.

The DOR does this by sending tax statements, developing clearly written tax forms, answering call center questions from taxpayers, processing paper and electronic payments, securely storing sensitive information confidentially, correctly assessing property values, managing information provided on the DOR website, developing understandable rules, discussing tax law with constituents, providing prompt refunds, and promptly and fairly applying active compliance, when appropriate. Most of this work is similar to the customer service, billing and collections department of any large firm, but in this case it is on behalf of Montana citizens.

Active compliance occurs when taxpayers do not voluntarily comply, requiring the DOR to take active steps to require proper compliance.



Tax gap is the cumulative estimate of tax payment noncompliance or, said another way, it is the gap between the amount of annual taxes due under the law and the amount voluntarily paid. Active compliance measures by the DOR are an effort to collect these taxes and close the tax gap, which in turn promotes voluntary compliance and fairness.

Voluntary compliance and active compliance tax payments are intuitively related to one another by way of the **deterrent effect**, in a similar fashion to the enforcement of other laws – for example,

the speed limit. When the highway patrol enforces the speed limit, people tend to drive the speed limit. When the highway patrol isn't able to enforce the speed limit, people tend to exceed the speed limit. In the case of tax payment, the DOR's active compliance work creates an incentive, thereby increasing taxpayers' willingness to voluntarily comply with tax law, (Witte R. D. and Woodbury (1985)).

As the DOR's strategies for active compliance increase, voluntary compliance payments increase together with active payments. Similar to the speeding example above, the deterrent effect works in the counter direction, too. If the DOR reduces active compliance measures, payments for both voluntary compliance and active compliance are reduced.

Montana Department of Revenue's Compliance Budgets, Revenue Collection Offer Significant Return on Investment

As a result of the recent recession, many states have experienced reduced budgets. Consequently, some states have conducted analyses in an effort to find which portions of their government's operating costs can be cut with the least effect on services and to total state budgets. Some states have experimented with reducing the budgets from active compliance and collecting other forms of revenue.

The consistent finding is that state departments charged with collecting voluntary and active compliance tax revenue provide a return of between six and thirteen dollars of additional revenue for each additional dollar of budget. Inversely, collection of tax revenue decreases by eight dollars for every one dollar removed from the budget as active compliance is reduced and the deterrent effect is diminished.

In 2009, California constituents lost an estimated \$465 million in tax revenue by reducing its Franchise Tax Board's compliance budget by \$65 million.

For example, according to the California Senate Office of Oversight and Outcomes, in 2009 the governor required furloughs of 5,300 workers at California's Franchise Tax Board in order to save an estimated \$65 million dollars in salaries. This resulted in an estimated 14% reduction in the number of hours spent on audit and collection activities and a corresponding reduction in personal, income, and corporate taxes of \$465 million, for a net overall loss of \$400 million (a loss of \$7.15 for every dollar saved).

Between FY 2006 and FY 2009, Montana constituents received an additional \$29,585,364 in revenue by investing \$2,310,800 in DOR compliance efforts, a return rate of \$12.80 for each dollar invested.

In contrast, in 2005 the Montana Legislature approved a DOR increase of \$1.12 million (per biennium) to fund services and operating costs to add 8 full-time employees for compliance activities. The employees were added in areas where other states have found significant non-compliance, namely individual income tax and corporate license tax – especially taxes owed by non-residents and out-of-state companies.

During the 2007 biennium, the DOR tracked the result of this investment and found in that biennium, the \$1,052,893 expenditure investment produced \$11,085,122 in additional revenue collected, a return of more than \$10.50 for each dollar invested.

During the 2009 biennium, the DOR continued tracking the return on investment in compliance. The results show expenditures of \$1,257,907, producing \$18,500,242 in additional revenue collected. This is a return of more than \$14.70 for each dollar invested.

Over the entire period from FY 2006 through FY 2009, the return was \$12.80 for each dollar invested.

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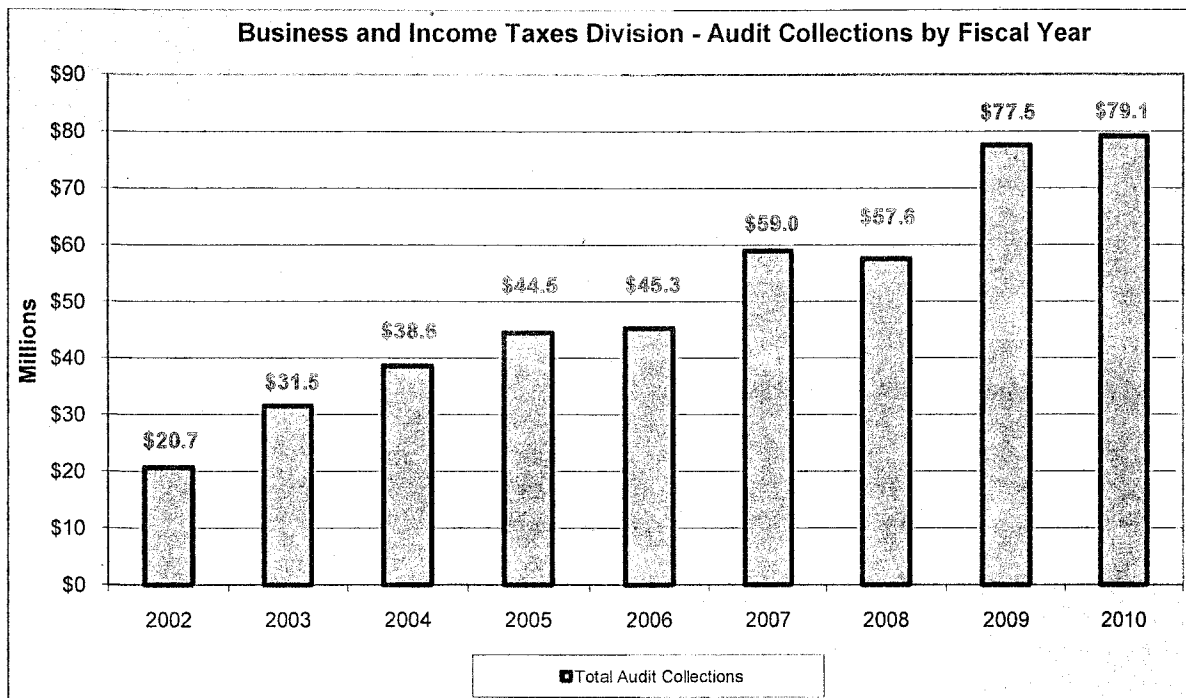
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Arizona	2009	(\$10,800,000)	(\$54,000,000)	5 to 1	5, 6
California - Board of Equalization	2009	(\$41,500,000)	(\$264,000,000)	6.4 to 1	2
California - Franchise Tax Board	2009	(\$65,000,000)	(\$465,000,000)	7.2 to 1	2
Idaho	2003	\$926,000	\$12,000,000	13 to 1	3
Kansas	2002	\$6,000,000	\$54,000,000	9 to 1	3
Kansas	2005	\$1,440,000	\$15,000,000	10.4 to 1	3
Minnesota	2003	\$10,300,000	\$97,200,000	9.4 to 1	3
Montana	2007	\$1,052,893	\$11,085,122	10.5 to 1	4
Montana	2009	\$1,257,907	\$18,500,242	14.7 to 1	4
New Mexico * (first year)	2009	\$5,000,000	\$29,000,000	5.8 to 1	3
New Mexico * (ongoing)	2010	\$5,000,000	\$45,000,000	9 to 1	3
Pennsylvania*	2009	(\$13,000,000)	(\$200,000,000)	15.4 to 1	7
Washington *	2009	\$10,700,000	\$67,800,000	6.3 to 1	3
* Projected					
<u>Sources:</u>					
1. Reducing the Federal Tax Gap - A Report on Improving Voluntary Compliance - Internal Revenue Service, U.S. Department of the Treasury - 8/2/2007.					
2. Furloughs at the Franchise Tax Board: Loss is Seven Times Greater than the Savings - California Senate Office of Oversight and Outcomes - 2/12/2010.					
3. Idaho's Tax Gap, 2009 Estimating Idaho's tax Gap and Developing Strategies to Reduce It - Idaho Tax Commission - 11/2009.					
4. Montana Department of Revenue 2007 Biennium Compliance Package Collections by Month and 2009 Biennial Compliance Package Collections by Month.					
5. Stronger Arizona - An estimate of state <u>general fund</u> losses as a result of Arizona Department of Revenue budget cuts.					
6. Arizona Department of Revenue - Office of the Auditor General, "division analysis indicates corporate income tax audits result in \$15 in assessments for each \$1 spent, while audits of individual income taxes result in \$5 in assessments for each \$1 spent."					
7. The Pennsylvania Budget and Policy Center: 30 Ways in 30 Days: Revenue Collections - Proposed Cuts to Revenue Department Penny Wise and Pound Foolish:					

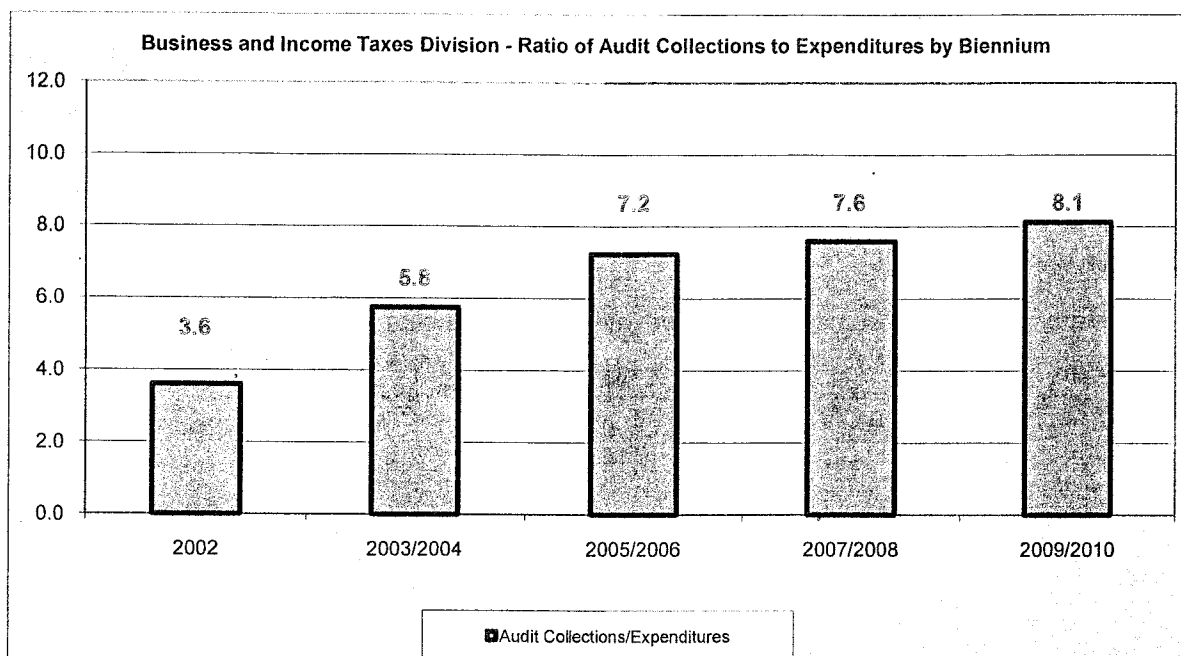
Overall Results of Montana Department of Revenue (DOR) Increased Compliance Efforts

Montana's recent compliance efforts have yielded increased tax collections. For each dollar the Montana Legislature has invested in compliance efforts, the DOR has returned from \$8 to almost \$15 in increased tax collections.

The table below demonstrates how effective investing in compliance efforts has been.



The second table (see next page) illustrates the overall return on investment the DOR has experienced with its compliance efforts. This ratio takes the audit collections from the above table and divides it by the amount that was appropriated for the Business and Income Taxes Division for each biennium. The overall return on investment of the Business and Income Taxes Division is lower than the marginal return on investment, which measures just the collections and expenditures of specific compliance programs.

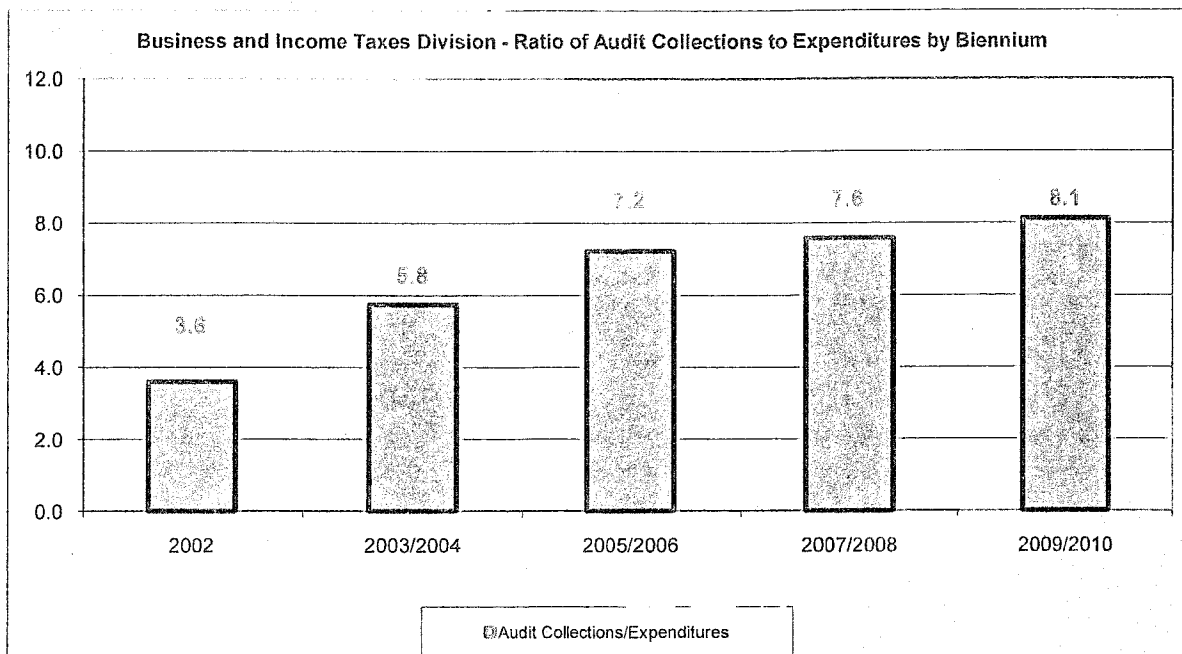


What are the benefits of better tax compliance?

Fairness in Taxation: Honest and diligent taxpayers who pay the right amount of taxes on time are protected from having to pay even more taxes to make up for those individuals and businesses not paying their fair share under Montana law.

A Stronger, Growing Economy: The Montana economy grows on a sustained basis if taxes are equalized so that businesses compete on a level playing field and if proper revenues are returned from out-of-state to flow through this state once again.

A Brighter Future for All Montanans: The future for all Montanans is improved through efficient public services, solid infrastructure and investments in education for higher paying jobs.



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Successfully Reducing the Tax Gap – Idaho's Experiment

As a state level example, in November of 2009 the Idaho Tax Commission produced a report, *Idaho's Tax Gap*, estimating Idaho's tax gap at \$255,000,000 and developing strategies to reduce it. (In times of budget shortfalls, shrinking the tax gap is a common method employed to increase revenue without increasing taxes.) This report includes three separate methods for estimating Idaho's tax gap, methods for reducing the tax gap, and a discussion of investments in tax compliance, proven return on investment, the multiplier effect, the opposite effect of reducing returns to investment, and the unintended consequences of "across the board" (including revenue collection agencies) budget cuts.

The major finding of Idaho's research was that reducing the tax compliance budget leads to a projected reduction in tax revenue that is 10 times greater than the expenditure budget, a 10-to 1 ratio of revenue reduction.

Unrealized potential for both Idaho untapped noncompliance measures are presented below. Idaho's data comes from *Idaho's Tax Gap, 2009*.

Tax Discovery

Idaho's Tax Discovery Bureau found 55,000 potential cases of individual income tax non-filers in 2009, and were only able to work about 5,000 of these cases. Although, each added employee creates around \$1,000,000 in additional revenue, there existed four vacancies, indicating potential gains from investment.

Front Line Phone Agents

Idaho's "Phone Power" front line of collection agents collect, on average, more than \$2,000,000, per year, per person, and had four vacancies.

Compliance Technicians and Compliance Officers

Idaho's compliance technicians and compliance officers work in tandem by phone, mail, and in the field. On average, they collect an estimated \$1,000,000 per person, per year. In 2009, they had six vacancies.

Auditors and Audit Technicians

Idaho's auditors and technicians collect, on average, \$400,000 per person, per year. In 2009, they had 10 vacancies.

Investments in Tax Compliance

In 2003, another year of budget shortfalls, Idaho's governor boosted the Tax Commission's compliance budget by \$926,000, allowing the creation of new compliance positions, which, in turn, produced a return of \$10,000,000, an average return on investment of \$13 in additional revenue to \$1 of increased budget. According to the Idaho Tax Commission, this ratio seemed reasonable when compared to the return on investment from other state's compliance efforts.

Federal Tax Gap and Compliance

In 2007, the Internal Revenue Service produced a report on improving voluntary compliance estimating, "the overall (federal) gross tax gap [estimated] to be approximately \$345 billion" and the "overall return from new investments in compliance averages 4:1" (page 2, IRS).

Summary

The statutory duty of the Montana Department of Revenue (DOR) is to administer the revenue laws as created by Montana's Legislature. Similar to the cashier at the restaurant, the product of the DOR is collected taxes, which are redistributed as revenue to local governments and state agencies.

The DOR is made up of six interrelated parts that work together to produce local and state revenue. Either through direct revenue collection or through operational support, each part of the DOR is vital to tax revenue collection.

Tax revenue collection is made up of voluntary compliance and active compliance. The DOR supports active compliance by providing the necessary framework that allows taxpayers to contribute their fair share of tax revenue in a timely manner.

When appropriate, the DOR uses active compliance measures to induce compliance. Like any other law under enforcement, voluntary compliance is directly related to the amount of resources allocated to active compliance measures by way of the deterrent effect. Montana and other states (as well as the federal government) understand the large return on investment that can be secured by increasing the budget for compliance.

Unfortunately, other states (Arizona, California, and Pennsylvania) have attempted to balance state budgets by removing resources previously allocated to their tax collection agencies. All three states experienced or predict large revenue losses from these shortsighted actions, ranging from a \$729 million loss in California to a \$54 million loss in Arizona.

On the other hand, due to a \$2,310,800 investment between FY2006 and FY2009, the DOR in Montana collected an additional \$29,585,364 in active compliance tax revenue, while ensuring that constituents were treated fairly under Montana's tax laws. Other states have had similar results and have been able to increase state and local revenue without having to increase taxes.

"Investing in tax compliance to reduce the tax gap is a
revenue-producing alternate to raising taxes"
(Idaho Tax Commission, 2009)

Information Sources

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Additional Reading Used for this Report

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 - a. revenue.mt.gov/content/abouttheagency/dept_goals/2011_Biennium_Goals_and_Objectives.pdf
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